Supreme Court of the United States

October Term, 1944.

Nos. 52-54 and 220-222.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

vs.

THE SCOTTISH AMERICAN INVESTMENT COMPANY, LIMITED, *Respondent*.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

vs.

BRITISH ASSETS TRUST, LIMITED, *Respondent*.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

vs.

SECOND BRITISH ASSETS TRUST, LIMITED, *Respondent*.

THE SCOTTISH AMERICAN INVESTMENT COMPANY, LIMITED, *Petitioner*,

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SECOND BRITISH ASSETS TRUST, LIMITED, *Petitioner*,

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURTS OF APPEALS FOR THE FOURTH AND THIRD CIRCUITS.

BRIEF FOR TAXPAYERS.

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Second British Assets Trust, Limited, Petitioner,

vs.

Commissioner of Internal Revenue, Respondent.

On Writs of Certiorari to the United States Circuit Courts of Appeals for the Fourth and Third Circuits.

BRIEF FOR TAXPAYERS.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 75-84) is reported in 47 B. T. A. 474; the opinion of the Circuit Court

of Appeals for the Fourth Circuit in Nos. 52-54 (R. 110-114) is reported in 139 F. (2d) 419, and the opinion of the Circuit Court of Appeals for the Third Circuit in Nos. 220-222 (Supp. R. 16-21)[1] is reported in 142 F. (2d) 401.

Jurisdiction.

In Nos. 52-54 the judgments of the Circuit Court of Appeals for the Fourth Circuit were entered November 9, 1943 (R. 114-118); on February 5, 1944, an order was signed by the Chief Justice extending for sixty days from February 8, 1944, the time within which a petition for writs of certiorari might be filed (R. 120); the petition for writs of certiorari was filed April 8, 1944, and was granted May 29, 1944.

In Nos. 220-222 the judgments of the Circuit Court of Appeals for the Third Circuit were entered April 6, 1944 (Supp. R. 21-23); the petition for writs of certiorari was filed July 3, 1944, and was granted October 9, 1944.

Questions Presented.

The taxpayers are foreign corporations, and they contend that during the taxable years 1936, 1937, 1938 and 1939 they were engaged in trade or business within the United States and had an office or place of business therein and accordingly were resident foreign corporations within the meaning of Section 231(b) of the Revenue Acts of 1936 and 1938 and the Internal Revenue Code. The Board of Tax

[1] The case was presented in the Board of Tax Appeals on one record which is included in the printed record in Nos. 52-54, referred to herein as "R". The record of the proceedings in Nos. 220-222 before the Circuit Court of Appeals for the Third Circuit and on petitions for certiorari and certain exhibits applicable only to the years involved in Nos. 220-222 are printed as the record in those numbers and referred to herein as "Supp. R".

Appeals sustained that contention. The questions in all the cases for all years are:

1. Whether the determination of the Board of Tax Appeals that the taxpayers had an office or place of business in the United States and that such office was used for the regular transaction of business must be regarded as final or whether such determination is subject to review and reversal by an appellate court.

2. Whether in the taxable years the taxpayers were engaged in trade or business in the United States or had an office or place of business therein and therefore were resident foreign corporations.

The Commissioner's brief (pp. 3-4) states that the question presented "is whether the Board of Tax Appeals' undisputed finding of fact that the taxpayers maintained an office in the United States to perform certain routine functions including the receipt of dividends and the keeping of records is sufficient to sustain its conclusion that the taxpayers are entitled to be classified as resident foreign corporations * * *". Whether the findings of the Board may be construed to mean that the functions of the taxpayers performed at such office were only routine, may be an arguable question, but certainly the Board made no such positive finding.

Statute and Regulations Involved.

The applicable provisions of the statute are Sections 231(b) and 211(b) of the Revenue Act of 1936, c. 690, 49 Stat. 1648 (applicable to the years 1936 and 1937), and the same sections of the Revenue Act of 1938, c. 289, 52 Stat. 447 (applicable to the year 1938) and of the Internal Revenue Code, c. 2, 53 Stat. 1 (applicable to the year 1939). Those

sections are in all material respects the same in each of the applicable acts, and such sections of the Revenue Act of 1936 are as follows:

"SEC. 231. TAX ON FOREIGN CORPORATIONS.

* * * * * * *

(b) *Resident Corporations.*—A foreign corporation engaged in trade or business within the United States or having an office or place of business therein shall be taxable without regard to the provisions of subsection (a), but the normal tax imposed by section 13 shall be at the rate of 22 per centum instead of at the rates provided in such section.

* * * * * * *

SEC. 211. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

* * * * * * *

(b) *United States Business or Office.*—* * * As used in this section, section 119, section 143, section 144, and section 231, the phrase 'engaged in trade or business within the United States' includes the performance of personal services within the United States at any time within the taxable year, but does not include the performance of personal services for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of ninety days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000. Such phrase does not include the effecting of transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian."

The pertinent provisions of Treasury Regulations 94, issued under the Revenue Act of 1936, which are in all material respects the same as the corresponding provisions

of Regulations 101, issued under the Revenue Act of 1938, and Regulations 103 (1939), issued under the Internal Revenue Code, are as follows:

"'Art. 231-1. *Taxation of Foreign Corporations.*—For the purposes of this article and articles 231-3, * * * foreign corporations are divided into two classes: (a) foreign corporations not engaged in trade or business within the United States and not having an office or place of business therein at any time within the taxable year, referred to in the regulations as nonresident foreign corporations * * *; and (b) foreign corporations which at any time within the taxable year are engaged in trade or business within the United States or have an office or place of business therein, referred to in the regulations as resident foreign corporations * * *'

(b) *Resident Foreign Corporations.*— * * *

As used in section 231, section 119, section 143, section 144, and section 211, the phrase 'engaged in trade or business within the United States' includes the performance of personal services within the United States at any time within the taxable year. Such phrase does not include the effecting of transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian.

Whether a foreign corporation has an 'office or place of business' within the United States depends upon the facts in a particular case. The term 'office or place of business,' however, implies a place for the regular transaction of business and does not include a place where casual or incidental transactions might be, or are, effected.

* * * * * * *

Art. 231-3. *Gross Income of Foreign Corporations.*

* * * * * * *

(b) *Resident Foreign Corporations.*—

* * * * * * *

A foreign corporation which effects transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian is not merely by reason of such transactions considered as being engaged in trade or business within the United States which would cause it to be classed as a resident foreign corporation. However, a foreign corporation which at any time within the taxable year is otherwise engaged in trade or business in the United States or has an office or place of business therein, being a resident foreign corporation, is taxable upon all income derived from sources within the United States, including the profits realized from such transactions. A resident foreign corporation is also required to include in its gross income capital gains, gains from hedging transactions, and profits derived from the sale within the United States of personal property, or of real property located therein.

Statement.

These cases, involving income taxes of the respondents-petitioners (hereinafter referred to as taxpayers) for the years 1936, 1937, 1938 and 1939, were consolidated for hearing before the Board of Tax Appeals, which decided in favor of the taxpayers and held that during the taxable years they were resident foreign corporations. The returns of the taxpayers for 1936 and 1937 were filed with the Collector of Internal Revenue for the District of Maryland (R. 76), and petitions for review of the Board's decisions with respect to those years were filed by the Commissioner

with the Circuit Court of Appeals for the Fourth Circuit, which affirmed the Board. The returns for 1938 and 1939 were filed with the Collector at Newark, New Jersey (R. 76), and petitions for review of the Board's decisions with respect to those years were filed by the Commissioner with the Circuit Court of Appeals for the Third Circuit, which reversed the Board. Writs of certiorari were granted by this Court to review the judgments of both Circuit Courts of Appeals.

The facts as found by the Board of Tax Appeals are fully set forth at pages 5 to 15 of the Commissioner's brief and are not repeated here. If, as the taxpayers contend, the Board's findings and the conclusion based thereon are final and the evidence may not be re-examined, no other facts should be considered. However, if the Court should decide to review and re-examine the facts and the evidence, the following additional facts which appear in the record are pertinent:

At the end of the years 1936, 1937, 1938 and 1939 the investments of taxpayers in United States securities were in round figures respectively as follows (R. 5, 12, 16):

	1936	1937	1938	1939
Scottish	$24,500,000	$25,000,000	$24,400,000	$20,000,000
British	15,100,000	16,200,000	16,000,000	12,000,000
Second British	8,500,000	8,600,000	8,400,000	6,100,000

During the taxable years the taxpayers made sales of securities through bankers and brokers in the United States and on such sales realized the following amounts (R. 67-7[illegible]; Supp. R. 1-13):

	No. of different lots of securities sold	Total amount realized
1936		
Scottish	67	$2,747,281.08
British	26	1,126,365.86
Second British	25	607,704.99
1937		
Scottish	47	1,363,297.36
British	24	916,330.30
Second British	25	200,989.32
1938		
Scottish	43	1,366,120.13
British	31	763,626.33
Second British	14	510,123.25
1939		
Scottish	62	3,059,919.67
British	72	4,845,852.58
Second British	39	2,082,955.38

Original advices of brokers as to all purchases and sales made after the United States office was opened were sent to that office (R. 36). Purchases and sales of securities were recorded on the books of the taxpayers which were kept in the United States office and which showed the cost prices of all American securities owned by the taxpayers (R. 10-12, 79).

Some years prior to the years in question the taxpayers had maintained an office in the United States, which had been abandoned (R. 32, 101). At the time the firm of accountants was engaged in preparing income tax returns for Scottish showing capital gains for back years when no office was maintained in this country, the preparation of such returns was difficult because of lack of adequate records, and the necessary figures were obtained only by extensive search of the records of brokers and banks (R. 101).

When the Manager of Scottish was in the United States in 1935 and talked with Cooper about reopening an American office, he expressed concern over the fact that Scottish had been required to pay more than $200,000 in interest on past due Federal income taxes because of its failure to report capital gains promptly. He referred to the fact that such interest was more than it would have cost to keep the United States office open right along, said that if the companies were to be faced with such problems in the future something should be done about it, and said that serious consideration should be given to the reopening of the office. (R. 101.)

When Cooper and his associate in the fall of 1936 discussed with officials of the taxpayers in Scotland the question of opening the United States office, one of the reasons stated by such officials for considering such office advisable was that they had found great difficulty in obtaining promptly statements of the financial condition of the American companies in which their funds were invested (R. 26). It was not until after the matter of opening a United States office had been discussed seriously at the conference in Scotland that there was a discussion of the effect of such office on the United States income tax payable by the taxpayers (R. 32). Cooper advised the taxpayers' officials at that conference that if a United States office were opened before the end of 1936, there would be a considerable saving in United States income taxes for that year, but he advised them also that the opening of such office might result in their having to pay considerably higher taxes in subsequent years (R. 33).

It is customary among British companies operating as investment trusts to appoint a secretary or assistant secretary to act for several companies and to pay him as compensation a sum from which he must pay the expense of

maintaining the office of the companies (R. 102-103). The firm of secretaries which managed the affairs of British and Second British at the home office in Scotland did substantially the same things which the United States representative did, plus making distributions to shareholders. The securities were held in custody accounts with British banks and the secretaries recorded income (R. 38).

A. W. Robertson-Durham was Chairman of the Board of Directors of all three taxpayers (R. 58-61, 104-106).

Specification of Errors to be Urged in Nos. 220-222.

1. The Circuit Court of Appeals for the Third Circuit erred in holding that the petitioners were not engaged in trade or business in the United States in 1938 and 1939 within the meaning of the statute and regulations.

2. The said Court erred in holding that the petitioners did not have an office or place of business in the United States in 1938 and 1939 within the meaning of the statute and regulations.

3. The said Court exceeded its appellate authority and erred in holding that the only real business of the corporations consisted of the purchase and sale of securities, a conclusion of fact contrary to the evidence and contrary to the conclusion of the Board of Tax Appeals that the collection at its office in the United States of income from many different sources and the numerous other activities of the petitioners in the United States constituted a very large part of the affairs of petitioners in the United States and the transaction of business.

4. The said Court erred in reversing the decisions of the Board of Tax Appeals.

Summary of Argument.

I.

The determination of the Board of Tax Appeals that the taxpayers had an office or place of business within the United States and that such office was used for the regular transaction of business was a determination of a question of fact which, being supported by substantial evidence, may not be reversed by an appellate court.

The Board of Tax Appeals and the Circuit Court of Appeals for the Third Circuit did not differ as to the meaning of the applicable statutes and regulations. However, the Third Circuit Court of Appeals drew inferences of fact from the evidence which were contrary to those drawn by the Board, and on the basis of such different inferences it reached an opposite ultimate conclusion. The appellate court had no authority to review the evidence and substitute its own conclusions for those of the Board. *Helvering v. National Grocery Co.*, 304 U. S. 282, 294 (1938); *Wilmington Trust Co. v. Helvering*, 316 U. S. 164, 168 (1942).

Even if it be held that the question at issue is not a pure question of fact, nevertheless, it is a question depending "upon the facts of a particular case" under the express language of the regulations. The Board did not make a clear-cut mistake of law and there was a rational basis for its decision. Therefore, the Board's decision should be regarded as final and is not subject to reversal on appeal. *Dobson v. Commissioner*, 320 U. S. 489 (1943).

Of all the cases which have been presented to the courts involving the question of whether a foreign taxpayer has an office or place of business in the United States, the decision of the Third Circuit Court of Appeals below is the only one which has reversed a decision of the Board of Tax Appeals, and that court in so doing exceeded its appellate authority.

II.

The evidence shows clearly that the taxpayers were engaged in trade or business within the United States during the taxable year. The business of the taxpayers, which were investment trusts, was to invest their funds so as to yield income, to collect such income and after paying expenses to distribute the net amount to their shareholders. It is not disputed that the taxpayers were engaged in trade or business, but the Commissioner's contention is that on the evidence they were not engaged in trade or business in the United States.

A large percentage of the investments of the taxpayers was in American securities, and these were held in custodian accounts in banks in this country. The taxpayers made many and large purchases and sales through brokers in this country and collected interest through banks and dividends through their United States office. Records were kept in their United States office of the purchases and sales and of their receipts and disbursements, and other activities were carried on which were necessary to safeguard the interests of the taxpayers with respect to their American investments. Although the statutory phrase "trade or business" does not include the effecting of transactions in securities through a custodian, the other activities were essential to the business of the taxpayer and are not excluded from the meaning of such phrase. The regulations provide that the effecting of transactions in securities through a resident custodian or broker "is not merely by reason of such transactions considered as being engaged in trade or business within the United States", and in view of the other activities of the taxpayers, their transactions in securities through brokers and custodians become material.

Where a corporation is organized for profit and is pursuing the ends for which it was organized, it is doing business. *Edwards* v. *Chile Copper Co.*, 270 U. S. 452 (1926). Measured by that test, the essential activities which were carried on in this country irrespective of the transactions through custodians and brokers constituted engaging in trade or business.

III.

In any event, the taxpayers in the taxable years had an office or place of business in the United States. The phrase "engaged in trade or business" and the phrase "having an office or place of business" are used in the statute in the disjunctive and are not synonymous. *B. W. Jones Trust* v. *Commissioner*, 132 F. (2d) 914 (C. C. A. 2, 1943). The cases in which it has been held that an office maintained by a foreign corporation was not an office or place of business within the meaning of the applicable statute and regulations are cases in which the office was a sham or in which the activities carried on through such office were not part of the essential activities for which the corporation was formed.

Here, however, the taxpayers maintained a *bona fide* office with full-time employees, where essential activities were carried on and complete records were kept. The officer of each taxpayer who had charge of such office had the same authority as any officer at the home office. The decision of the Board of Tax Appeals was clearly correct in holding that the taxpayers during the taxable year were resident foreign corporations within the meaning of the statute.

Argument.

POINT I.

The determination of the Board of Tax Appeals was final and may not be reversed on appeal.

The statute does not define the phrase "engaged in trade or business", except to exclude certain specified transactions, or the phrase "having an office or place of business". The regulations (Art. 231-1(b), Reg. 94) provide that whether a foreign corporation has an office or place of business within the United States "depends upon the facts in a particular case".

The Board after a consideration of all the evidence found full facts bearing on the question at issue and determined that the taxpayers had an office or place of business in the United States and that such office was used by them for the regular transaction of business. The Circuit Court of Appeals for the Fourth Circuit upheld the Board's conclusion, while the Circuit Court of Appeals for the Third Circuit, after reviewing the facts, substituted its own conclusion for that of the Board and decided that the taxpayers were not resident foreign corporations.[2]

In the course of its opinion the Board clearly stated factual inferences, including: "* * * an office handling affairs to this extent must be regarded as real and substantial. It was here that a very large part of the affairs of petitioners in this country were taken care of. It [the office] * * * was maintained in this country because of

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[2] The Circuit Court of Appeals for the Third Circuit neither discussed nor cited the decision of the Circuit Court of Appeals for the Fourth Circuit, although counsel for the taxpayers mailed three copies of the opinion of the latter court to the former court more than three months before its decision was rendered.

the administrative necessity of having local supervision of its affairs. * * *. The office was used for the regular transaction of business and not as a place where casual or incidental transactions might be, or were, effected" (R. 83-84).

The Circuit Court of Appeals for the Third Circuit reviewed the evidence and drew contrary factual inferences on which its ultimate conclusion obviously depended, namely: "They [the Boards of Directors] did everything of any importance in connection with these concerns, * * *. The so-called United States office functioned solely on routine matters. * * * the business of that office had only to do with the unimportant collateral detail, voluminous though such might be, * * *". The Court also implied that the office was not "bona fide in the sense that it functioned truly on the one business of the taxpayers." (Supp. R. 19, 21).

There was no difference between the Board and the Third Circuit Court of Appeals as to the meaning of the applicable statutes and regulations. The differences were in the factual inferences drawn from the evidence, and their ultimate conclusions depended upon the respective inferences so drawn. The aforementioned inferences by the Board were supported by an abundance of evidence and the appellate court had no authority to substitute its own conclusions for those of the Board. *Helvering* v. *National Grocery Co.*, 304 U. S. 282, 294 (1938); *Helvering* v. *Rankin*, 295 U. S. 123, 131 (1935); *Helvering* v. *Lazarus*, 308 U. S. 252, 255 (1939); *Wilmington Trust Co.* v. *Helvering*, 316 U. S. 164, (1942); *Regensburg* v. *Commissioner*, 144 F. (2d) 41 (C. C. A. 2, 1944).

As was said in the *Wilmington Trust Company* case (316 U. S. at p. 168):

> "It is the function of the Board, not the Circuit Court of Appeals, to weigh the evidence, to draw

inferences from the facts, and to choose between conflicting inferences. The court may not substitute its view of the facts for that of the Board. Where the findings of the Board are supported by substantial evidence they are conclusive."

The Commissioner's argument in this Court consists largely of reviewing and reweighing the evidence which was considered by the Board and asking the Court to draw factual inferences and conclusions contrary to those drawn by the Board.

The question at issue before the Board of whether the taxpayers had an office or place of business in the United States or were engaged in trade or business therein is essentially a question of fact (Art. 231-1 (b), Reg. 94).

No error of law by the Board of Tax Appeals has been pointed to either by the Circuit Court of Appeals for the Third Circuit, which reversed the Board, or by the Commissioner in his brief. The conclusion of the Board of Tax Appeals that the office of the taxpayers in the United States was used for the regular transaction of their business and that they were accordingly resident foreign corporations is one for which the appellate court should not substitute its own conclusion.

But even if the question at issue be considered a mixed question of law and fact, the decision of the Board is nevertheless final.

This Court in *Dobson* v. *Commissioner*, 320 U. S. 489 (1943), reexamined the power of appellate courts to review and reverse decisions of the Tax Board and in comprehensive language delineated that power. The Court held that the Circuit Court of Appeals had no authority to reverse the Tax Board's determination that the taxpayer did not realize income on the recovery of a loss deducted on his

return in a prior year, when such deduction did not result in a tax benefit. The controlling principles stated by the Court were:

> "But 'the judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body.'" (p. 501.)
>
> * * * * * *
>
> "* * * when the court cannot separate the elements of a decision so as to identify a clear-cut mistake of law, the decision of the Tax Court must stand." (p. 502.)
>
> * * * * * *
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> "Where no statute or regulation controls, the Tax Court's selection of the course to follow is no more reviewable than any other question of fact." (p. 502.)
>
> * * * * * *
>
> "The statute gives no inkling as to the correctness or incorrectness of the Tax Court's view, and we can find no compelling reason to substitute our judgment." (p. 507.)

The decision of the Board in the instant cases was in complete harmony with the statute and regulations. The Board determined from the facts that the taxpayers came within the definition of resident foreign corporations as used in the statute and regulations, and there is nothing in the statute or regulations which requires a different conclusion. There was a rational basis for the Board's decision, and it should be treated as final.

The Court in the *Dobson* case cited with approval certain of its prior decisions upholding the finality of the decisions of administrative officials or boards on mixed questions of law and fact. Among these decisions are *Gray v. Powell*, 314 U. S. 402, 411-412 (1941); *Mississippi Valley*

Barge Line Co. v. *United States*, 292 U. S. 282, 286-287 (1934); *Shields* v. *Utah Idaho Central Railroad Co.*, 305 U. S. 177, 180-181 (1938); *Swayne & Hoyt* v. *United States*, 300 U. S. 297, 307 (1937). See also *Parker* v. *Motor Boat Sales*, 314 U. S. 244, 246 (1941); and *National Labor Relations Board* v. *Hearst Publications*, decided April 24, 1944, 64 S. Ct. 851.

In each of those cases the Court reiterated the principle that even where there is no dispute as to the evidentiary facts, an appellate court may not substitute its judgment for that of the administrative tribunal on an issue as to which a contrary decision is not dictated by a controlling principle of law.

The Commissioner's brief (p. 22) argues that since there is "no substantial controversy between the parties as to the subsidiary facts, i.e., what the activities of the taxpayers were", the *Dobson* case merely means that such subsidiary facts as determined by the Board may not be reviewed, but that the conclusion to be drawn from those facts is subject to appellate review. The Commissioner's brief differs sharply from the Board as to what the activities were. However, the Court in the *Dobson* case and the other cases last cited above decided that even if there is no dispute as to the evidentiary facts the rule of finality is not limited to such facts found by the administrative tribunal, but applies to all determinations not in conflict with a provision of the statute or regulations, where there is no clear-cut mistake of law and there is a rational basis for the administrative determination. As was said in *Gray* v. *Powell supra* (314 U. S. at p. 412):

> "Although we have here no dispute as to the evidentiary facts, that does not permit a court to substitute its judgment for that of the Director. * * * It is not the province of a court to absorb the administrative

functions to such an extent that the executive or legislative agencies become mere fact-finding bodies deprived of the advantages of prompt and definite action."

Commissioner v. *Heininger*, 320 U. S. 467 (1943), presented the question of whether attorney's fees and expenses incurred in defending unsuccessfully a fraud order issued by the Postmaster General were deductible as ordinary and necessary business expenses. The Board of Tax Appeals decided against the taxpayer, but solely because of its reversal by the Circuit Court of Appeals in a similar case which it had decided in favor of a taxpayer. The Circuit Court of Appeals reversed the Board's decision in the *Heininger* case, and this Court affirmed the Circuit Court, saying (p. 475):

> "Whether an expenditure is directly related to a business and whether it is ordinary and necessary are doubtless pure questions of fact in most instances. Except where a question of law is unmistakably involved a decision of the Board of Tax Appeals on these issues, having taken into account the presumption supporting the Commissioner's ruling, should not be reversed by the federal appellate courts."

The effect of the decision in the *Heininger* case is that if the Board had decided that the expenses were or were not ordinary and necessary business expenses on the basis of the facts before it and not because of a decision of a higher court which was erroneous, its decision would have been final.

Here, there is no controlling legal principle which requires a contrary decision, and the determination of the Board that the taxpayers had an office or place of business

in the United States and that such office was used for the regular transaction of business, must stand.

Finally, in every case which has presented the question of whether a foreign taxpayer has an office or place of business in the United States, with the single exception of the decision of the Third Circuit Court of Appeals below, the decision of the Board of Tax Appeals has been affirmed. See *Aktiebolaget Separator* v. *Commissioner*, 128 F. (2d) 739 (C. C. A. 2, 1942), affirming 45 B. T. A. 243 (1941); *Linen Thread Co.* v. *Commissioner*, 128 F. (2d) 166 (C. C. A. 2, 1942), affirming memorandum decision of Court of Tax Appeals; and *B. W. Jones Trust* v. *Commissioner*, 132 F. (2d) 914 (C. C. A. 4, 1943), affirming 46 B. T. A. 531 (1942). The taxpayer's appeal to the Circuit Court of Appeals for the Fourth Circuit in *Recherches Industrielles* v. *Commissioner*, 45 B. T. A. 253 (1941), was dismissed October 4, 1943.

POINT II.

The taxpayers were engaged in trade or business within the United States.

In addition to its determination that during the taxable years the taxpayers had an office or place of business within the United States, the Board found that "the office was used for the regular transaction of business and not as a place where casual or incidental transactions might be, or were, effected" (R. 84). A holding that the office *was used* for the regular transaction of business is necessarily a holding that the petitioners were engaged in trade or business within the United States.

If the Court should reexamine the facts of the case, it will be found that the evidence amply justifies that finding and that the petitioners clearly were so engaged in trade or business.

In *Flint* v. *Stone Tracy Co.*, 220 U. S. 107 (1911), which arose under the Corporation Excise Tax Act of 1909, the Court approved the following definitions of business (at p. 171):

> "'Business' is a very comprehensive term and embraces everything about which a person can be employed. * * * 'That which occupies the time, attention and labor of men for the purpose of a livelihood or profit.'"

The petitioners were investment trusts, and the business of each consisted of investing its capital funds for the primary purpose of realizing a profit. The profit took the form of income derived and collected from such investments. The collection of such income and the keeping of records pertaining to the income and to the purchases and sales of securities were essential parts of the business for which the petitioners were organized. The gathering of information affecting the investments, including studying reports and making recommendations with respect to the reorganization of corporations in which funds were invested, was likewise an essential part of the prudent conduct of this business. Those things were done in the United States through the office maintained by the taxpayers and ~~by their officers~~ and employees.

The time and attention required ~~for~~ those matters is indicated by the fact that the investments in American securities amounted to approximately $50,000,000 and the dividends collected each year through the United States office amounted to $1,500,000 to $2,000,000.

Also, the taxpayers made a large number of sales of securities through brokers in the United States in each of the four years, of which Scottish made sales of from 43 to 67 lots of securities for amounts ranging from $1,360,000 to $3,000,000 per year, British made sales of 24 to 72 lots of

securities for sums ranging from $800,000 to $4,800,000 each year, and Second British sold from 14 to 39 lots of securities at prices ranging from $200,000 to $2,000,000 each year (R. 67-64; Supp. R. 1-13).

The statute (Sec. 211(b)) provides that the phrase "engaged in trade or business within the United States" does not include sales through a resident broker or custodian. However, the regulations (Art. 231-3(b)) provide that a foreign corporation is not *merely* by reason of such transactions through a resident broker or custodian considered as being engaged in trade or business within the United States, thus indicating that such transactions are to be taken into consideration along with other activities in order to determine whether the corporation is engaged in trade or business. In addition to other activities the United States office received the original brokers' advices of purchases and sales, recorded all such transactions in the books and in many cases directed what securities should be delivered to effectuate sales.

Where the only activities of a foreign corporation in the United States consisted of effecting purchases and sales through brokers in this country and it had no officer or representative and maintained no office here, it was held not engaged in trade or business, even in the absence of a statutory provision excluding such transactions from the definition of trade or business. *Union Internationale de Placements* v. *Hoey*, 96 F. (2d) 591 (C. C. A. 2, 1938). The Court said (at p. 593) that the corporation "could come into the jurisdiction and be present here only by sending into the jurisdiction or maintaining here its officers or other agents". Compare *Berliner Handels-Gesellschaft* v. *United States*, 30 F. Supp. 490 (Ct. of Cls., 1939) cert. den. 309 U. S. 670 (1940).

It is not disputed that during the taxable years the taxpayers were engaged in trade or business (R. 82). The position of the Commissioner appears to be that the business of the taxpayers was transacted in its entirety at their home offices in Scotland and that no essential part of such business was carried on in the United States. It is true that meetings of directors were held at the home office and decisions were made and orders issued from there with respect to the purchase and sale of securities. Nevertheless, the American securities constituted approximately 40% of the total investments of the taxpayers, and the collection of dividends, the keeping of proper records with respect to such dividends and with respect to the purchase and sale of securities, and the gathering and transmitting of the necessary financial data with respect to the corporations in which such investments were made were essential parts of the entire business carried on by the taxpayers.

Where a corporation is organized for one purpose and discontinues the activity for which it was organized and reduces its activities to the mere collection of income and the distribution of such income among its stockholders, or where the corporation merely receives income from leased property and carries on no activity in the management of its property, it has been held that the corporation is not engaged in trade or business. See *McCoach* v. *Minehill Railway Co.*, 228 U. S. 295 (1913); *United States* v. *Emery*, 237 U. S. 28 (1915); *Zonne* v. *Minneapolis Syndicate*, 220 U. S. 187 (1911). *Cf. Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503 (1917). On the other hand, an individual, trust or estate which merely invests its funds and collects income is not engaged in business however large the volume of transactions. *Higgins* v. *Commissioner*, 312 U. S. 212 (1941); *City Bank Farmers Trust Co.* v. *Helvering*, 313 U. S. 121 (1941); *United States* v. *Pyne*, 313 U. S. 127 (1941).

But the revenue authorities would be the last to contend that a domestic corporation formed for the purpose of and doing nothing but investing its funds and collecting income therefrom is not engaged in business and therefore liable to pay the Federal capital stock tax and declared value excess profits tax (Art. 42 of Regs. 64, *infra*). In *Edwards v. Chile Copper Co.*, 270 U. S. 452 (1926), the Court said (pp. 455-456):

> "The exemption 'when not engaged in business' ordinarily would seem pretty nearly equivalent to when not pursuing the ends for which the corporation was organized, in the cases where the end is profit. In our opinion the plaintiff was liable to the tax. We do not rest our conclusion upon the issue of bonds in the first year or the call loans made in the last, and for the same reasons we cannot let the fagot be destroyed by taking up each item of conduct separately and breaking the stick. The activities and situation must be judged as a whole."

This test was applied to a holding or investment company in *Phillips v. International Salt Co.*, 274 U. S. 718 (1927) reversing *per curiam* 9 F. (2d) 389 (C. C. A. 3, 1925). The Circuit Court of Appeals held that the corporation's activities amounted to "no more than acts incidental to the ownership of property" and that "they are not the positive, aggressive acts incidental to the active carrying on or doing business for gain, but rather the receipt of the gains of business capitalized in ownership." The Supreme Court reversed on the authority of its decision in the *Chile Copper Company* case. See also *Stanley Securities Co. v. United States*, 38 F. (2d) 907 (Ct. Cls., 1930) cert. den. 282 U. S. 845.

In *American Investment Securities Co. v. United States*, 112 F. (2d) 231 (C. C. A. 1, 1940), although the activities of the corporation were few, it was held to be doing busi-

ness and subject to the capital stock tax, where "It is still in active quest of profits and has not abandoned the business from which it originally sought to derive those profits" (at p. 233). The court stressed the tendency of the decisions to confine the exemption narrowly. See also *Harmar Coal Co.* v. *Heiner*, 34 F. (2d) 725, 728 (C. C. A. 3, 1929).

At the time Sections 211 and 231 of the Revenue Act of 1936 were enacted, Congress had the benefit of the tests prescribed in *Flint* v. *Stone Tracy Co.* and *Edwards* v. *Chile Copper Co.*, *supra*, and also the capital stock tax regulations then in force (Art. 42 of Reg. 64), which embodied and elaborated on the tests established in those cases.[3] In using the phrase "engaged in trade or business" in those sections, Congress used it in the same sense in which it had been construed in the decisions of this Court and the regulations then outstanding. See G. C. M. 17014, XV-2 C. B. 317 (1936).

The Commissioner's brief attempts to split the activities of the taxpayer between those relating solely to purchases and sales and those relating to collecting the income from the investments and argues that the business of the tax-

[3] Art. 42 of Reg. 64. Doing business.—The term "business" is very comprehensive and embraces whatever occupies the time, attention, or labor of men for profit. Accordingly, regardless of the nature of its activities, any corporation organized for profit and carrying out the purpose of its organization is doing business within the meaning of the Act. Similarly, even if not organized for profit, any corporation which nevertheless engages in activities ordinarily carried on for profit is also doing business. It is immaterial whether the activities result in a profit or a loss, whether the corporation has been successful in its enterprise, or that because of unfavorable business conditions, no operations are carried on for a particular period. No particular amount of business need be done, nor is it necessary that the business be continuous throughout the taxable year.

The case is exceptional in which the activities of a corporation organized for profit do not amount to doing business within the meaning of the Act. Such a case is generally limited to one in which the corporation is not pursuing the ends for which organized, *i. e.*, profit.

payer was investing funds, not collecting income, and that therefore the collecting of income was not a business activity. It is a sufficient answer to this to point out that the very purpose of investing funds is to produce income and that if the income were not collected, the very purpose of the taxpayers' business would be defeated. Moreover, this Court made it clear in the *Chile Copper Company* case that the chain of activities which as a whole constitute the doing of business may not be broken by considering each activity separately.

Measured by every test, the activities carried on by the taxpayers in the United States were essential parts of their entire activities, and during the taxable years they were engaged in trade or business within the United States.

POINT III.

The taxpayers had an office or place of business in the United States.

The phrase "office or place of business" is not synonymous with the phrase "engaged in trade or business". *B. W. Jones Trust v. Commissioner*, 132 F. (2d) 914, 917 (C. C. A. 4, 1943). The statutory language is in the disjunctive and not the conjunctive. In the 1942 Act Congress amended the law and eliminated the phrase "office or place of business" and limited resident corporations and alien individuals to those engaged in trade or business within the United States. This established a single test and brought the income tax provisions into harmony with the capital stock tax provisions (see Sec. 160, Revenue Act of 1942, and Sec. 1200, I. R. C.). The change from a dual test to a single test leaves no doubt that the intent and purpose of Congress in the Revenue Act of 1942 differed from its

intent and purpose in the 1936 and intervening Revenue Acts.

The intent of Congress in the 1936 Act is logically and clearly revealed in the history of taxation of alien individuals and foreign corporations under our income tax statutes.

Prior to 1936, all revenue acts had required foreign corporations and nonresident alien individuals having income and capital gains from sources within the United States to file annual returns of net income and pay tax on net income at the same rates which were imposed upon domestic corporations, citizens and residents. Administration of this requirement was difficult and unsatisfactory where the taxpayer was a nonresident, beyond the jurisdiction of the tax authorities, and adequate information about his affairs could not be obtained. In many instances no returns were filed and proper audit of such returns as were filed was impracticable. In large measure the tax could not be collected, especially on capital gains.

Collection of the tax at the source was limited to withholding at normal tax rates on "fixed or determinable annual or periodical"[4] items of income, such as interest, rents and royalties. There was no withholding on dividends, which were not subject to the normal tax, or on capital gains, which are not fixed or determinable annual or periodical income.[5] In many cases the withholding tax was the only tax collected.

The phrases "office or place of business" and "engaged in trade or business" were no doubt drawn from the withholding provisions of the Revenue Act of 1934 and prior

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[4] Sec. 143(b), Rev. Act, 1934, and corresponding provisions of prior acts.

[5] Art. 143-2, Reg. 86 (1934) and corresponding provisions of prior regulations.

Acts. Section 143 (b) of the Revenue Act of 1934 and corresponding provisions of prior Acts provided that United States paying agents should withhold tax at the source on income paid to nonresident aliens "not engaged in trade or business within the United States and not having any office or place of business therein". The withholding provisions obviously were concerned solely with collection, and Congress did not deem it necessary to withhold from aliens who had any office or place of business or carried on a trade or business within the United States in order to assure collection.

Such had been the state of the law regarding nonresident aliens and foreign corporations from 1913 to 1936. When the Revenue Act of 1936 was under consideration, Congress decided to revise the method of taxing foreign taxpayers in order to remedy the defects in respect of collection and administration. Accordingly, it divided foreign corporations and alien individuals into two classes (1) those engaged in trade or business within the United States or having an office or place of business therein and (2) those not so engaged in trade or business and not having such office or place of business.

As to the second class, the tax was imposed on gross income at a flat withholding rate (less than the rates on net income), with no further tax liability, and capital gains were made exempt from tax. This was because of the difficulty of collecting the tax by any method other than withholding and because it was impossible for withholding agents to ascertain the amount of capital gains, and because it was considered desirable to encourage foreign taxpayers to retain their investments in American securities and continue to make purchases and sales in this country (See hearings before House Ways and Means Committee on Revenue Act of 1936, 74th Cong., 2d Sess., pp. 161-174).

Those falling in the first class were taxed in exactly the same way that they had been taxed since 1913, that is, on the basis of their net income, and they continued liable to make annual returns of their entire income, including capital gains, from sources within the United States and were allowed the corresponding deductions and credits which were allowed to domestic corporations and citizens.

This change in the policy of Congress toward foreign corporations and alien individuals was thus limited to those cases in which the established method of taxation could not be applied successfully because of administrative difficulty and lack of jurisdiction over the persons and properties of the taxpayers. The other class of foreign taxpayers was placed on the same basis for taxation as citizens and domestic corporations, that is, in the same way that they had always been taxed.[6]

The purpose of Congress in making the change in the method of taxing such taxpayers is indicated in the Committee Reports on the Revenue Bill of 1936 (74th Cong., 2d Sess., H. R. Rep. No. 2475, p. 10; Sen. Rep. No. 2156, p. 23) where it is stated in part:

> "It is believed that the proposed revision of our system of taxing non-resident aliens and foreign corporations will be productive of substantial amounts of additional revenue, since it replaces a theoretical system impractical of administration in a great number of cases."

It is thus clear that the revision was designed to create a workable tax system and not to impose a greater tax bur-

[6] See "Collecting the Revenue", Tax Magazine for October, 1936, pp. 586, 590, where Mr. Eldon P. King, Special Deputy Commissioner of Internal Revenue, stated as to alien individuals and foreign corporations located within this country that "Enforcement of our general provisions as to this class of taxpayers has presented no greater problems than it has as to citizens".

den on foreign taxpayers than on residents. Congress in effect gave foreign taxpayers their choice of submitting or not submitting to the jurisdiction of the United States. If they did not, their taxes would be paid in full by being withheld at the source at a lesser flat rate on gross income, and they would not be subject to tax on capital gains. If they chose to bring themselves within the jurisdiction of this country to the extent necessary to insure accurate determination and collection of their tax liability, they would, as in the past, pay tax on the same basis as citizens or other residents.

The office of the taxpayers, at which was conducted a large part of the affairs essential to their business in the United States, at which complete records were maintained, and which was supervised by one resident officer at all times and two resident officers a part of the time, clearly brought the taxpayers within the jurisdiction of the United States and fully met the purpose of Congress.

Of course the purpose of Congress would not be served by an office without real substance. Thus, it has been held that where a foreign manufacturing corporation merely maintained space in the office of a subsidiary with a part time employee who had no responsibility and its only activities consisted of receiving dividends from two domestic corporations, or where a foreign corporation had a common office shared with many other unrelated entities and had no books of account, maintained no bank account, collected no income and had no permanent employee, it did not meet the requirement of the law. *Aktiebolaget Separator* v. *Commissioner*, 128 F. (2d) 739 (C. C. A. 2, 1942), affg. 45 B. T. A. 243 (1941); *Recherches Industrielles* v. *Commissioner*, 45 B. T. A. 253 (1941), appeal to C. C. A. for 4th Circuit dismissed October 4, 1943. Similarly, where the foreign taxpayer was a manufacturing corporation, carried on none

of its regular business activities in this country, its office was in charge of a resident agent who was an employee of an American subsidiary and who acted under a power of attorney, and the income collected at such office consisted of dividends on three American investments. *Linen Thread Co. v. Commissioner*, 128 F. (2d) 166 (C. C. A. 2, 1942), affg. memo. dec. of Board of Tax Appeals.

The Board of Tax Appeals, which decided each of those cases, reached a different conclusion on the facts of the instant cases, and the facts fully support that conclusion. In contrast to the facts upon which the decisions in the last cited cases were based, a review of the considerations giving rise to the opening of the United States office and the essential functions of the taxpayers which were performed there will show that the office complied with the provisions of the statute and regulations and with the purpose of Congress in enacting the statute.

Some years prior to the years in question the taxpayers had maintained an office in the United States, which had been abandoned (R. 32, 102). During the years 1927 to 1934, when no office was maintained in this country, Scottish had realized large capital gains on the sale of securities in this country. Capital gains are not regarded as income under the British law, and British investment corporations may not pay dividends out of capital gains or show such gains in their profit and loss accounts. As a consequence and because of lack of proper information about the United States income tax laws, Scottish did not file Federal income tax returns for those years. (R. 76.) The accounting firm of which Walter A. Cooper was a member was employed to make an audit of the transactions of Scottish over that period, and as a result of that audit Scottish paid Federal income taxes of more than $1,000,000 on capital gains for those years, together with interest in excess of $200,000

(R. 76-77). The preparation of the returns was a difficult task because of the lack of adequate records, and the necessary figures were obtained only by searching the records of brokers and bankers (R. 101).

In 1935, before there was any provision of the Federal income tax law treating resident foreign corporations differently from nonresident foreign corporations, the Manager of Scottish was in the United States and discussed with Cooper the question of opening a United States office (R. 77). He was concerned about the large amount of interest which Scottish had had to pay on back United States taxes, referred to the fact that such interest was more than the expense of keeping the office here would have been, and said that if his companies were to be faced with problems of that sort serious consideration should be given to reopening the American office (R. 101). In the fall of 1936 Cooper and an associate were in Scotland and discussed further with the officials of taxpayers the opening of a United States office (R. 77). One reason stated by such officials as to why a United States office was considered desirable was that the taxpayers had found difficulty in obtaining financial statements promptly and in keeping themselves abreast of the financial condition of the many United States corporations in which they had invested in the aggregate approximately $50,000,000 (R. 26).

It was not until after the matter of opening a United States office had been discussed seriously at the conference in Scotland that there was a discussion of the effect of such office on United States income taxes payable by the taxpayers (R. 32). The new provisions of the income tax law applied for the entire year 1936 to a corporation having an office or place of business in the United States during any part of that year (Reg. 94, Arts. 231-1 and 231-3(b)), and Cooper advised that there would be a considerable

saving in taxes for the year 1936 if the office were open before the end of that year. However, such office would render the taxpayers subject to tax on capital gains, on which Scottish had been required to pay such a large tax for prior years, and Cooper was careful to advise that the United States office might result in their having to pay larger taxes in subsequent years than if they had no such office.[7] (R. 33.)

Thus, while the difficulties over United States income taxes for past years, due to their failure to maintain an office in this country, caused the taxpayers to consider the advisability of reopening their United States office, there is no indication that current and future taxes were the principal consideration which caused them to reestablish that office.

When the decision was made to open an office in the United States, the office was designed to be a real headquarters for the taxpayers' affairs in this country, where its dividends could be collected, proper records kept, and full information gathered and transmitted to the home office with respect to the American investments of the taxpayers. Dependence on custodians had proved unsatisfactory and in the case of Scottish, costly. It was resolved to have a fully responsible representative in the United States who could give the necessary attention to those matters.

The directors did not appoint a mere clerk or part-time employee with no authority or responsibility, but they appointed Cooper an Assistant Secretary, a position of re-

[7] The Commissioner's brief in a footnote at p. 47 says that "It is apparent, of course, that an investor owning large numbers of different securities, can, in the normal course, neutralize the gain he may have on one sale by selecting another security which can be sold at a loss". The mere statement of that contention is its own refutation, for it assumes that regardless of market conditions the taxpayers would always have securities on which losses had accrued.

sponsibility and trust. He was instructed to establish and take charge of an office and to look after the affairs of each of the taxpayers in this country, and he was given at least as great authority as any officer was given at the home offices of the companies. Among other things, his duties consisted of collecting and depositing dividends, paying all the local expenses, keeping records of the great volume of transactions which the company had in this country, making periodical reports (usually once a week) on economic and political developments here as they affected taxpayers' interests, gathering and sending abroad financial data on corporations in which funds were invested, taking care of proxies, studying and making recommendations with respect to plans for the reorganization of companies in which funds were invested, disposing of stock rights and scrip, designating the specific stock certificates to be transferred on a sale by one of the taxpayers of less than all of its holdings of stock of a particular corporation, preparing income and capital stock tax returns, and other duties, all of which were an indispensable part of the investment trust business of the taxpayers.

The duties entrusted to Cooper were discharged fully. At least two full-time employees were needed and retained during the years in question to look after the taxpayers' affairs, and they were supervised by Jeffers. In fact, the volume of taxpayers' activities in this country was so great that nothing short of a full-fledged office would have sufficed. This is shown not only by the nature of the records kept but also by the number of entries made therein. These records included a general ledger, embodying a security investment control account showing the cost of securities owned; a security ledger containing a separate account for each stock and bond owned which showed the number, date

of acquisition and cost of each certificate; a general ledger; a cash book; and a set of debit and credit vouchers.

The regulations provide that an office or place of business "implies a place for the regular transaction of business and does not include a place where casual or incidental transactions might be, or are, effected" (Reg. 94, Art. 231-1(b)). Thus, the affairs of the taxpayers which enter into the determination of its Federal income tax liability must flow through the office regularly and not occasionally or incidentally. That the acts performed by the United States office of the taxpayers were performed regularly and not incidentally is beyond question. The records maintained at the office provided full information for all United States tax purposes and nothing more was needed to insure the determination and collection of the full tax on net income. In addition, the acts of the officers and employees in the United States constituted an integral part of the business for which the taxpayers were organized and operated.

Reduced to its essentials, the Commissioner's argument is that the business of the taxpayers was solely investing their funds, which he defines as buying and selling securities and nothing else; that since decisions of what and when to buy and sell were made in Edinburgh and not in the United States, there was no office or place of business in this country. As already shown, the business of an investment company cannot be so limited. The Board found that each of the taxpayers was "engaged in the business of investing the funds of its security holders for the primary purpose of deriving income from investments" (R. 76), and after citing *McCoach v. Minehill Railroad Co., supra,* continued "it does not follow that the collection of the income of a large investment trust from hundreds of different sources is not to be regarded as the transaction of

business" (R. 84). The Commissioner's definition of the business of an investment company is not only incorrect but as applied to the meaning of the phrase "office or place of business" would eliminate all distinction between that phrase and "carrying on a trade or business", which may not be done.

The facts fully justify the conclusion reached by the Board of Tax Appeals and the Circuit Court of Appeals for the Fourth Circuit.

Conclusion.

The taxpayers during the taxable years were engaged in trade or business within the United States and had an office or place of business therein and were resident foreign corporations within the meaning of the statute and regulations. The judgments of the Circuit Court of Appeals for the Fourth Circuit should be affirmed, and the judgments of the Circuit Court of Appeals for the Third Circuit should be reversed.

Respectfully submitted,

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